SUMMARY OF
COMPROMISE PROPOSAL ON PBGC PROVISIONS
AND PENSION FUNDING

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of the

JOINT COMMITTEE ON TAXATION

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Summary of Proposed Resolution of Major Issues Relating to PBGC and Pension Funding

1. Pension funding rules - Generally follow Finance Committee bill, with modifications:

a. Frequency of waivers - For purposes of the rule limiting the frequency of waivers, waivers received for plan years beginning before January 1, 1988, are disregarded.

b. Funding rules for event-contingent (i.e., shutdown) benefits - Event-contingent benefits are taken into account in calculating contributions required under the cash flow rule and are funded ratably over a 5-year period with an offset for contributions under the cash flow rule.

c. Special funding rule for steel companies - Follow Ways and Means Committee bill with a 10-year amortization of new shutdown benefits

d. Effective dates - Generally effective for plan years beginning after December 31, 1988. Cash flow rule phased in according to the following schedule: 5% for 1989 and 1990, 10% for 1991, 15% for 1992, 20% for 1993, 30% for 1994, 40% for 1995, 50% for 1996, 60% for 1997, 70% for 1998, 80% for 1999, 90% for 2000, and 100% for 2001.

2. Access of employers to assets of overfunded pension plans upon plan termination - Participants are required to receive the following portion of the amount of any reversion payable to an employer upon plan termination: (1) If the employer maintains a replacement plan for 5 years, 10 percent of the reversion; (2) if the employer maintains a plan that is not a replacement plan, 20 percent; and (3) if the employer does not maintain any plan following the termination, 40 percent. The present-law 10-percent excise and income tax on reversions would continue to apply to the portion of any reversion paid to an employer. The Ways and Means Committee special funding rule for contributing the amount of a reversion to underfunded plans would apply with modifications. Effective date.--Notice to participants of plan terminations after December 17, 1987.

3. Security interests and liens

a. Lien for missed contributions - Statutory tax lien as in Finance Committee bill, arising 30 days after the due date for the contribution. The employer is required to notify the PBGC of the missed contribution.

b. Security for underfunded plans - If a plan providing a benefit increase has a funded ratio of less than 60

percent, the employer must provide security in favor of the plan (e.g., a bond).

c. Distress termination standards - In the case of a reorganization, a distress termination is not available unless the bankruptcy court (or other appropriate court) determines that, unless the plan is terminated the plan sponsor will be unable to pay its debts when due and will be unable to continue in business. Effective for notices to participants of plan termination after December 17, 1987.

4. Floor/offset plans - Provision of Education and Labor Committee bill would apply to floor/offset plans established after December 17, 1987.

5. Pension portability - Ways and Means Committee and Senate Finance Committee would hold hearings on pension portability in 1988.

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FUNDING AND PBGC PROVISION: COMPROMISE PROPOSAL

I. Minimum Funding Standards and Deductions

A. Minimum Funding Standards and Deductions

1. Affected plans. Finance Committee bill.

2. Calculation of contribution. Finance Committee bill, with the following modifications.

(a) For affected plans, the minimum required contribution as determined under the bill is increased by the unfunded portion of the amount of benefit payments (including single sum distributions and payments for the purchase of annuity contracts). This cash flow rule is effective for plan years beginning after December 31, 1988, with the effects of the rule phased in at a rate of 5 percent for 1989 and 1990, 10 percent for 1991, 15 percent for 1992, 20 percent for 1993, and an additional 10 percent for each year thereafter (i.e., 100 percent in 2001).

(b) Gains and losses due to changes in actuarial assumptions are amortized over 10 years.

(c) The unfunded old liability is amortized over 18 years.

(d) Unpredictable event contingent benefits--

Delete the 100 percent cash flow rule. Provide that unpredictable event contingent benefits are taken into account in calculating contributions required under the cash flow rule (set forth in (a)), and require 5-year funding of event contingent benefits once an event occurs. Amounts required to be contributed under the 5-year amortization rule are reduced by the portion of the annual contribution in the cash flow rule in (a) attributable to unpredictable event contingent benefits.

3. Cap on additional contribution. Finance Committee bill.

4. Funded ratio. Finance Committee bill, except that in calculating current liability, preparticipation service taken into account under the plan for individuals

first becoming participants after the effective date and not previously covered by a defined benefit plan of the employer is taken into account ratably over the first 5 years of participation. This rule is nonelective. The interest rate used for determining a plan's current liability is the rate used by the plan for funding purposes generally, except that such rate must fall within 10 percent of the 4-year average interest rate for 30-year Treasury bonds. Secretary of Treasury does not have authority to set plan rates outside the range or establish a different indicator. The Secretary may adjust a rate within the range if the rate is not reasonable.

5. Definition of existing liabilities. Finance Committee bill.

6. Valuation of assets. Finance Committee bill, with valuation of bond rules adjusted to conform to interest rate change.

Effective Dates. Finance Committee bill, except that the cash flow rule is effective as described above.

Special funding rule for steel companies: Ways and Means Committee bill, except that liabilities with respect to unpredictable event contingent benefits with respect to which the event occurs after the date of conference action and during the first 5 years after such date are not taken into account under the general rule, and the rule is increased by the amount necessary to amortize such liabilities over 10 years.

B. Time for Making Contributions

Finance Committee bill. Phasein of installments: 25 percent of otherwise required amount for plan years beginning in 1989, 50 percent for plan years beginning in 1990, 75 percent for plan years beginning in 1991, and 100 percent for plan years beginning in 1992.

Failure to make installments.--

(a) Finance Committee bill with respect to interest on missed contributions. The interest rate continues at the specified rate until the missed contribution is paid.

(b) Finance Committee bill with respect to notice for failure to make contributions, except that the notice is to be provided to all participants (including alternate payees).

(c) Lien for missed contributions.--Finance Committee bill, with the following modifications. In the case

of a plan with a funded ratio of less than 100 percent, a statutory tax lien arises on all controlled group property in favor of the plan 30 days after the due date of an unpaid contribution (whether or not a waiver application is pending). The amount of the lien is the cumulative missed contributions in excess of $1 million. Missed contributions originally due before the effective date are not subject to this lien provision (but they are taken into account in applying the $1 million rule). Also, plans maintained by an employer (or a member of the controlled group of the employer as defined in Code section 414) with fewer than 25 defined benefit participants are exempt from this provision. In determining the number of participants for purposes of this rule, the same rules apply as with respect to the rule for 100-participant plans.

(d) Penalty for failure to make contributions by final due date (excise tax).--Finance Committee bill.

(e) The controlled group is liabile for the minimum funding requirements. This does not affect deduction rules.

C. Funding Waivers

Standards for granting waivers.--Ways and Means, Education and Labor, and Labor and Human Resources Committee bills.

Time for requesting waivers. A waiver request must be submitted within 2-1/2 months after the end of the plan year.

Frequency of waivers. Follow Ways and Means, Education and Labor, and Labor and Human Resources Committee bills. Employers will not be treated as exceeding the number of permissible funding waivers due to waivers granted with respect to plan years beginning before January 1, 1988.

Notice of waiver requests.--Education and Labor Committee and Labor and Human Resources Committee bills.

Interest rate charged for waived contributions. Ways and Means and Finance Committee bills.

Amortization period for waived contributions. Labor and Human Resources Committee bill.

Security for waivers. Education and Labor, Finance, and Labor and Human Resources Committee bills except that the present-law threshold with respect to which the IRS may require security, etc. is reduced from $2 million to $1 million.

Effective date. Ways and Means Committee bill, except that June 30, 1987, is changed to December 17, 1987.

D. Amortization period for unfunded liabilities

Education and Labor and Labor and Human Resources Committee bills, except that the interest rate is the same as the rate for waived contributions and the threshold for security is reduced from $2 million to $1 million.

Effective date. Same as applies to waiver provisions.

E. Experience gains and losses

Finance Committee bill.

Effective date. Finance Committee bill.

F. Gains and losses due to changes in assumptions

Reduce present law amortization period from 30 years to 10 years.

Effective date. Finance Committee bill.

G. Actuarial assumptions must be reasonable

Finance Committee bill, except that the interest rate applicable in determining current liability must be used with respect to section 412 generally if the funded ratio of the plan is less than 100.

Effective date. Finance Committee bill.

H. Limitation on amortization of past service credits

Ways and Means Committee bill, effective for plan years beginning after December 31, 1987. The effective date is not intended to create any inference with respect to present law.

I. Limitation on deduction for contributions to certain plans not less than unfunded termination liability

Finance Committee bill. In determining current liability for purposes of this rule, assets are not reduced by credit balances.

Effective date. Finance Committee bill.

II. Employer Access to Plan Assets

Current law, with the following modifications.

(a) Provide that participants are required to receive a portion of the amount of any reversion received by an employer upon plan termination. The portion of the reversion that participants would receive would be determined in the following manner: (1) If the employer maintains a replacement plan, the participants would receive 10 percent of the reversion, with a cushion as described below; (2) if the employer maintains a plan that is not a replacement plan, the participants would receive 20 percent of the reversion; and (3) if the employer does not maintain any plan or maintains a sham plan following the termination, the participants would receive 40 percent of the reversion. An employer generally would be considered to maintain a plan that is not a sham plan even if contributions to the plan are within the discretion of the employer. A plan is not a replacement plan unless it is maintained for at least 5 years after the termination. The present-law 10-percent excise and income tax on reversions would continue to apply to the portion of any reversion received by the employer. These provisions would be in Title I of ERISA (with appropriate reference to Title IV), as well as the Code.

Allocation of amounts as in either Education and Labor or Labor and Human Resources Committee bill, subject to Code sections 401(a)(4) and 415. Legislative history to provide that this rule does not create an inference with respect to ownership of the excess assets.

(b) Allocation of excess assets to employee contributions.--Education and Labor and Labor and Human Resources Committee bills.

(c) Education and Labor and Labor and Human Resources Committee bill with respect to effective date of plan amendments providing for an employer reversion, with a 1-year transition rule for plans that do not have such provisions.

(d) Special funding rule with respect to an employer reversion. - Ways and Means Committee bill except that:

(1) In general.

(i) The unfunded amount would be calculated once (as under the Education and Labor Committee and Labor and Human Resources bills) and amortized over 4 plan years;

(ii) The unfunded amount would be the amount by which current liability exceeds plan assets.

(2) Replacement plans. A special rule would apply to the replacement plan described above. For purposes of the replacement plan rule, (A) the unfunded amount would be recalculated each of the 4 plan years (as under the Ways and Means Committee bill); (B) the unfunded amount would be the

amount by which 110 percent of current liability exceeds plan assets; and (C) the amount contributed to the replacement plan under this rule would be separately limited to 10 percent of the reversion.

(3) Transfers. Tax-free transfers of net assets from one defined benefit plan of an employer to another defined benefit plan of the same employer would be permitted, subject to the restrictions noted below. These transfers would be treated like an employer contribution for purposes of the special funding rule. In addition, the Secretary would be instructed to prescribe regulations requiring that in transactions affecting defined benefit plans within an employer (such as plan mergers or spinoffs) assets in excess of termination liability would be allocated based on the excess of projected liability over termination liability. Similar principles would apply to transfers between plans. Transfers from defined benefit plans to defined contribution plans would be treated as reversions and recontributions (subject to the present-law ESOP exception).

(4) Mergers and Acquisitions. The special funding rule would not apply as a result of transactions such as mergers and divestitures of business activities.

(5) Security.--Follow Ways and Means Committee bill.

(6) Waiver. Follow Education and Labor and Labor and Human Resources Committee bills.

(e) Prior underfunded benefits

An employer would not have access to excess asset to the extent that the employer previously terminated an underfunded plan and has not fully compensated the PBGC and participants in such plan.

Effective date. In general, plan terminations where notice of the termination is sent to employees after December 17, 1987, terminations instituted by the PBGC after December 17, 1987, and affected transactions after December 17, 1987.

III. Treatment of Plan Terminations

A. Employer liability to participants

Ways and Means, Education and Labor, Finance, and Labor and Human Resources Committee bill. Substitute the following for the provision in the Ways and Means bill regarding the section 4049 trust:

Eliminate the section 4049 trust and liability to trust under 4062(c). Increase employer liability to PBGC for all

unfunded benefit liabilities. Participants will be paid a percentage of their unfunded benefit liabilities in excess of guaranteed benefits equal to the percentage recovered by PBGC on the total claim. For example, if PBGC recovers 15 percent, participants will be paid 15 percent of unfunded nonguaranteed benefits. Amounts will be allocated to participants in accordance with section 4044. Generally, the recovery percentage determined from PBGC past experience; in large cases (i.e., unfunded benefit liabilities in excess of guaranteed benefits of at least $20 million), data from that termination will be used. Applies as of the date of enactment (grandfather for 4049 trusts established before the date of enactment).

B. Employer liability to the PBGC

Ways and Means, Education and Labor Committee, and Labor and Human Resources Committee bills.

C. Standards for termination

1. Standard termination. Ways and Means, Education and Labor, Finance and Labor and Human Resources Committee bills. Use the term benefit liabilities.

2. Distress termination.

Finance Committee bill, except that a reorganization qualifies as a distress criteria only if (in addition to the present-law requirements) the bankruptcy (or other appropriate) court determines that the entity will be unable to pay its debts when due and will be unable to continue in business.

Education and Labor Committee bill with respect to provision regarding a reorganization that has been converted to a liquidation, notification to PBGC, and date of determination of whether distress criteria have been satisfied.

Termination charge. Ways and Means, Finance, and Labor and Human Resources Committee bills.

Effective date.--Terminations where notice of the termination is provided to participants after December 17, 1987, and terminations instituted by the PBGC after December 17, 1987.

D. Replacement plans

Finance Committee bill.

E. Security and lien rules for underfunded plans

Finance Committee bill, modified.

If a plan has a funded ratio of less than 60 percent, the contributing sponsor and members of the controlled group of the contributing sponsor must provide security in favor of the plan (e.g., a bond) equal to the excess of (A) the lesser of (1) the amount by which the plan's assets are less than 60 percent of current liability, taking into account the benefit increase and prior unfunded benefit increases, or (2) the amount of the benefit increase, over (b) $10 million. The employer must notify the PBGC of the benefit increase before the benefit increase is effective. Finance Committee bill effective date and transition rule applies.

F. Information requirements

Education and Labor Committee bill. The penalty shall reflect the materiality of the failure.

IV. Increase in Premium Rates

A. Flat Rate Premium

Ways and Means Committee bill, except that the rate is increased to $16.

B. Additional Charge for Underfunded Plans

Ways and Means Committee bill, except that the additional premium is $6.00 per $1,000 of unfunded vested benefits. The maximum additional premium is $34.

The additional premium is reduced for 5 years following the effective date by $3 for each year preceding the effective date for which the employer made the maximum deductible contributions to the plan. The interest rate used in valuing vested benefits is 80 percent of the annual yield under 30-year Treasury Constant Maturities.

C. Small Employer Exemption

Education and Labor and Labor and Human Resources Committee bill.

D. Liability for Premium Payments

Finance Committee bill.

E. Accounting for Additional Premium Income

Finance Committee bill, effective for fiscal 1989.

Effective Date. Except as provided above, plan years beginning after December 31, 1987.

V. Miscellaneous provisions

A. Notification of employees

Ways and Means Committee bill, but require notice only with respect to plans that are funded below 70 percent of current liability.

B. Statute of limitations with respect to certain reports

Education and Labor Committee bill.

C. Penalty for failure to provide annual report in complete form

Follow Education and Labor Committee bill. The penalty shall reflect the materiality of the failure.

D. Interpretation of provisions under the Internal Revenue Code and ERISA

Ways and Means Committee bill, with the modification that except to the extent provided by the Code or determined by the Secretary of the Treasury, Titles I and IV of ERISA are not applicable in interpreting the Code. Adopt Education and Labor Committee bill with respect to determination letters.

E. Sanctions for prohibited transactions that are continuing in nature

Education and Labor Committee bill.

F. Multiemployer plans

In general, rules not to apply to multiemployer plans. Follow provisions in Education and Labor Committee bill with respect to multiemployer plans subject to confirmation by multiemployer groups.

G. Plan investment in employer securities

1. Ten-percent limit

Education and Labor Committee bill, effective with respect to arrangements established after December 17, 1987.

2. Definition of qualifying employer security

Education and Labor Committee bill, except that the general effective date is changed to December 17, 1987.

H. Interest on Employee Contributions

Labor and Human Resources Committee bill, effective for years beginning after December 31, 1987.

I. Study of Event Contingent Benefits

Ways and Means and Finance Committee bills.

VI. Provisions Relating to Pension Plan Portability

Ways and Means and Finance Committee bills. Ways and Means and Finance Committees will hold hearings on portability during 1988. The Administration will not oppose a modified portability proposal in future legislation.